Market Snapshot – June 2016

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The Year Ahead Six Months In

By James Gauthier

We are almost half way through 2016, and for June's Monthly, we thought it would be worthwhile to revisit some of the key themes brought up by the presenters at our annual Year Ahead Conference to see how things are progressing.

The Year Ahead Conference, which takes place each January, is the Private Client Research group's showcase conference. At this event, investment experts from within and external to Scotiabank discuss themes, ideas and trends in front of nearly 250 HollisWealth advisors. What's the purpose of the event from the perspective of the attendees? To give them the investment tools and information required to help them build better client portfolios.

The conference's investment experts are not charged with providing their best guess as to what their area of expertise may look like six months out. Our view is that making such short term forecasts is a mug's game. The real purpose of their calls is to give advisors a longer term sense of how client portfolios should be positioned. But it wouldn't be much fun if we didn't have the opportunity to put together a short term review of how some of the key calls and comments brought up by the presenters have fared since the event.

With that in mind, we've put together a summary of some of the key comments from some of the investment experts during the January 20th event, along with details on what's happened since.

Derek Holt, VP, Scotiabank Economics

Key Conference Highlights:

On China:

- The core problems of the world economy have to do with imbalances, many of which are centered in China
- China's forex reserves reached US$4 trillion and the nation has been redeploying this. This is working to address the imbalances.
- China is trying to depreciate its currency without letting it go into freefall. Forex reserves have been falling as it purchases yuan in the market to manage the currency depreciation
- The yuan has run up more than 60% in the past 10 years making China a much less competitive exporter. Weak global growth also has not helped

On the U.S.:

- The Fed will move slowly, marking possibly the most muted hiking cycle ever
- Treasury yields should remain in a low range for an extended period of time
- The U.S. has finally deleveraged. Household debt service as a share of after tax income at a record low; household wealth to after-tax income is essentially at an all-time high.

On Canada:

- We are courting more problems with continued monetary easing than we are solving. The problem with debasing the currency is that we have high import propensities
- We have not seen an export pickup, suggesting there is little to support debasement.
- Core inflation is on the rise. As this import pass-through accelerates further, this should continue.

The Picture Today:

- Chinese first quarter GDP growth came in at a healthy 6.7%. Chinese currency since the January 18 conference has been relatively flat vis-à-vis USD.
- The U.S. Fed has not taken any additional action on rates, while U.S. 1- year treasury yields have actually declined

from about 2% since the conference to 1.7% at present.

- The Bank of Canada has taken no action since the conference and the Canadian dollar has seen a material amount of strength; rising to $0.77 from $0.68 CAD/USD.
- Canadian CPI inched lower through March but jumped slightly to 1.7% on a YoY basis through the end of April.

Myles Zyblock, Chief Investment Strategist, Dynamic Funds

Key Conference Highlights:

- Global growth is sluggish at about 3.1%. Expected growth in the U.S., Europe and Japan is 2-2.5%, 1.5-2% and 1-1.5%. respectively
- Headwinds for growth in the U.S. include a recession in the manufacturing sector, a strong USD and soft non-residential investment
- In Canada, a 40% drop in energy capex has had a big impact on aggregate GDP. Even excluding energy, Canadian growth has slowed to 0.5% YoY
- Stocks are moving into short term oversold territory and are probably near a bottom. However, the sustainability of a rally would be questionable
- Flattening yield curves (the spread between 2 and 10 year treasuries) seem to be indicative of higher volatility moving forward

The Picture Today:

- Q1 GDP growth came in quite light, with the U.S., Japan and the Euro Zone posting improvements of 0.8%, 1.7% and 0.6%. Canadian GDP was up 1.1% YoY
- Banks have increased provisions for credit losses due to challenges out of the energy patch. At the same time, S&P/TSX Capped Energy Index is up more than 30% since the conference
- The S&P/TSX Composite index was up 19% during the same period
- WTI has gone from US$46 to US$49 during the period, although it did get to as low as US$26, and U.S. oil rig count has declined to a bit more than 300 from 500.
- North American yield curves have indeed flattened marginally

Patricia Mohr, VP & Commodity Market Specialist, Scotiabank Economics

Key Conference Highlights:

- For the sake of commodity prices, it would be great to see the USD stabilize and even move lower
- A stabilization of oil prices would do a great deal to bring the TSX back up. Oil and gas make up 40% of all of Canada's commodity exports
- Might be a transition year for gold. What drove gold prices up at the end of the last decade was QE as it was viewed as a massive inflationary step. Gold began to trek downward as QE was unwound.
- Outlook for gold is US$1,200 in 2016 and US$1,300 in 2017
- OSB (oriented strand board) is the top pick. It is a panel board used in residential construction. Prices will be lifted by modest further recovery in U.S. housing starts in face of limited mill supply.
- Crude oil prices may average US$35 - US $40 in 2016. Will stay low for now however, and could hit US $25 in the short term.

The Picture Today:

- The USD has moved lower as commodity prices in general have trended higher

- Oil prices have stabilized, but as noted earlier, WTI did slide all the way down to $26 before rising back to $50
- Gold moved from US$1090/oz at the time of the conference to around US$1240 today and got as high as US$1294. The price is fairly flat in CAD terms, however
- OSB prices have moved from US$253 per 1000 board feet to US$307

Pammi Bir, Director, Research Analyst, Real Estate & REITs, Scotiabank

Key Conference Highlights:

- Next twelve month total return estimated at ~25% vs. -4.6% in 2015 for Canadian REITs. Positive view supported by outlook for low bond yields and improving economic traction
- Top picks: CT REIT (CRT.UN-T), WPT Industrial (WIR.U-T), SmartREIT (SRU.UN-T), First Capital Realty Inc. (FCR-T), Pure Industrial REIT (AAR.UN-T)

The Picture Today:

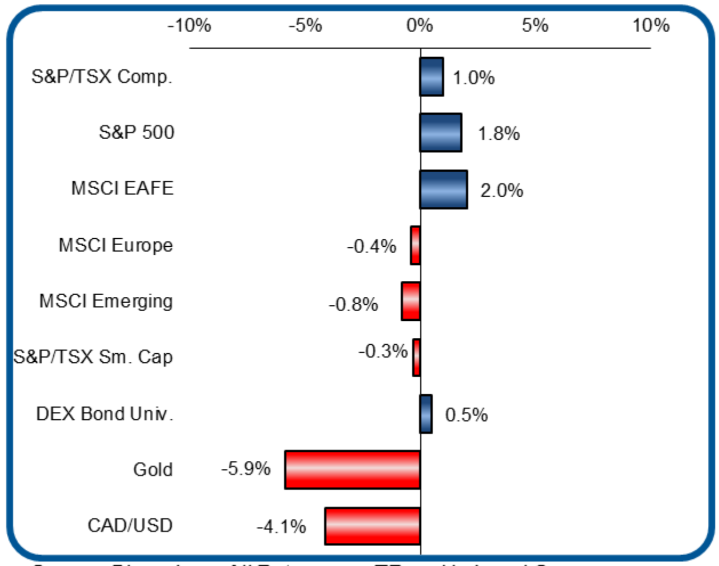
- The S&P/TSX REIT Total Return Index has risen 22% since the conference
- Here are the total return numbers for the stocks mentioned: CRT.UN-T: 8.1%, WIR.U-T: 9.5%, SRU.UN-T: 12.8%, FCR-T: 14.8% AAR.UN-T: 17.3%

MONTHLY OVERVIEW

Global equities were mixed during May. The S&P/TSX Composite finished the month up 1%, and its gain on a YTD basis was 9.4% to May 31. The info tech sector posted the largest gain during the month, jumping 8.4%. Canadian health care stocks were the largest losers, giving back 6.7% after adding over 15% in the prior month. In the U.S., the S&P 500 traded up 1.8%, putting its year-to-date performance firmly in the green at 3.6%. Gains were also chalked up in Europe, with the Stoxx Europe 600 Index up 2.7%. In China, the Shanghai Composite lost 0.6%. (All returns in local currency terms)

Even after contracting for a second month in March, real GDP in Canada grew at an annual pace of 2.4% in the first quarter, although the growth rate for Q1 fell short of economists' estimates of 2.9%. Headline manufacturing sales for March declined by 0.9%, although this was better than the estimated dip of 1.9%. Declines in the motor vehicles and parts, aerospace and primary metal sales components were the largest laggards in the data. The silver lining was that the volume of manufacturing sales, stripping out pricing effects, did increase slightly, by 0.1%.

1 MONTH RETURNS



Source: Bloomberg, All Returns are TR and in Local Currency

As widely expected, the Bank of Canada held rates steady during its May meeting. A strengthening loonie, on the back of a pickup in energy prices, had increased fears that the manufacturing and export sectors would take a hit and necessitate a currency-weakening rate cut. The increased expectations of a rate move at the Fed meeting in June, however, tempered those fears as the greenback strengthened, pushing down the loonie. Bank of Canada Governor Stephen Poloz stated that the Bank will continue to keep an eye on the strength in the non-resource sectors of the economy, oil and gas prices, and the potential effects of the large fiscal stimulus package.

In the U.S., Consumer spending rose 1% during April. The stronger than expected pickup in spending was led by stronger sales of motor vehicles and parts which were at their strongest level in two years. Services and non-durables spending also increased. Supporting the acceleration in spending was a 0.4% increase in personal income growth and a drop in the household savings rate. The Fed's preferred inflation gauge, the personal consumption expenditure deflator (PCE), also rose to 1.1% year over year, from 0.8% in March. Core PCE remained unchanged at 1.6%. CPI data reflected a rise in core prices as well as food and energy with both the headline and core readings registering rises. Headline CPI rose 1.1%, and core prices were up 2.1%. If the strength in consumer spending continues into the second half of 2016, this could further buoy inflation data.

May was rife with increasingly hawkish statements from Fed Presidents and the minutes released from the last meeting indicated that a June rate hike is potentially on the table. At a speaking event early in the month, Philly Fed President Patrick Harker stated that "two or three rate hikes over the remained of the year" was a possibility; and that "if the data comes in... I think a June rate increase is appropriate." This was followed up when both San Francisco and Atlanta Fed Presidents' John Williams and Dennis Lockhart stated that June would be a "live" meeting, meaning the prospect of a rate increase is on the table. There are, however, significant economic data releases expected in June ahead of the next meeting on the 15th that market watchers will continue to keep an eye on including the jobs report, inflation data, inventories, jobless claims and retail sales.

MARKET OUTLOOK

Core CPI in the U.S. has been at or above the 2% mark for six months now. Increasing energy prices, a strengthening labour market, and rising consumer spending all support the prospect of further increases in prices. In a vacuum, this strengthens the case for another rate increase; however, risks from global financial market and economic developments and new domestic economic data will continue to sway the Fed's outlook. Investors' focus will remain on the data as it rolls out ahead of the Fed meeting on June 15th. It is worth noting that non-farm payrolls have been positive but at a declining rate with 233K jobs added in February, 186K in March and 123K in April. The Bank of Canada has predicted that the shutdown of many oil sands operations as a result of the wildfires in Fort McMurray could shave 1.25% off real GDP in Q2. This implies a contraction for the quarter may be in the cards as the Bank forecasted Q2 growth of 1% in its April monetary policy report.

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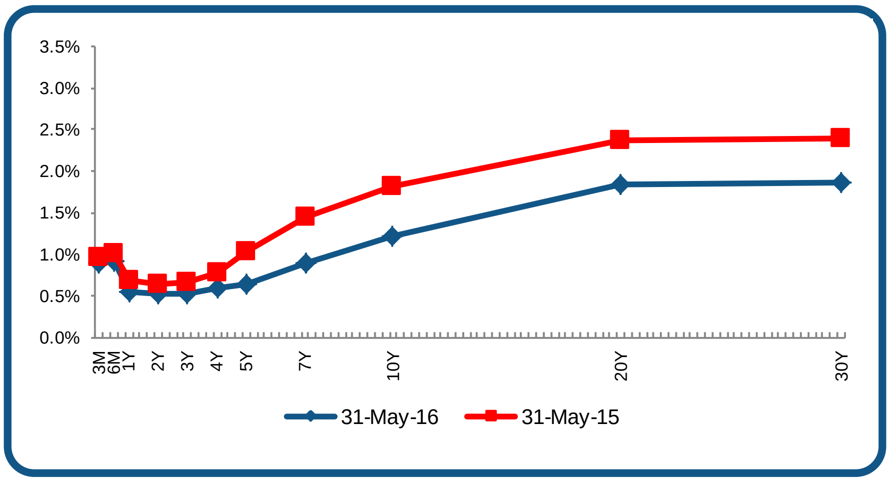
Monthly Market Statistics: May 2016

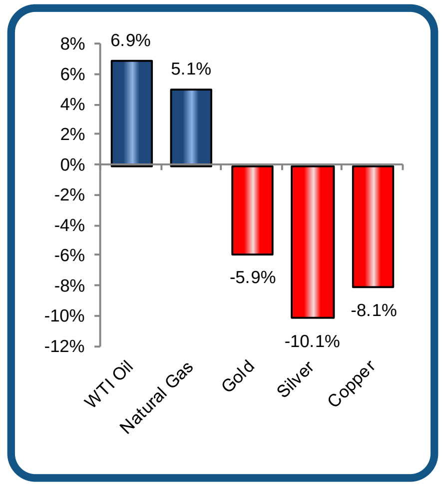
Total Return Index Returns (Annualized After One Year)

	Local Currency Returns							Canadian Dollar Returns						
	1M	3M	6M	YTD	1YR	3YR	5YR	1M	3M	6M	YTD	1YR	3YR	5YR
TSX Composite	1.0%	10.2%	6.1%	9.5%	-3.3%	6.8%	3.4%	1.0%	10.2%	6.1%	9.5%	-3.3%	6.8%	3.4%
S&P 500	1.8%	9.1%	1.9%	3.6%	1.7%	11.1%	11.7%	6.2%	5.6%	0.0%	-1.9%	6.9%	20.1%	18.6%
MSCI EAFE	2.0%	6.5%	-5.9%	-3.2%	-10.4%	6.3%	7.3%	3.5%	5.4%	-3.9%	-6.0%	-4.6%	10.8%	9.0%
MSCI World	1.9%	8.3%	-1.2%	0.9%	-3.7%	8.9%	9.4%	5.0%	5.8%	-1.6%	-3.3%	1.5%	15.8%	13.8%
MSCI Pacific	2.2%	8.0%	-7.4%	-6.7%	-14.5%	6.6%	9.3%	2.8%	6.1%	-2.5%	-6.7%	-4.3%	10.8%	9.9%
MSCI Emerging	-0.8%	7.4%	0.9%	1.9%	-10.9%	1.7%	1.7%	0.4%	6.1%	-1.7%	-3.0%	-13.1%	3.1%	1.4%
TSX Small Cap	-0.3%	20.3%	19.7%	21.6%	0.6%	4.3%	-2.3%	-0.3%	20.3%	19.7%	21.6%	0.6%	4.3%	-2.3%
Global Small Cap	2.6%	11.3%	0.1%	3.1%	-3.0%	9.7%	9.4%	5.6%	8.9%	0.0%	-1.0%	2.6%	16.8%	13.9%
CDA Bond Uni.	1.8%	2.5%	4.3%	3.2%	3.7%	4.6%	5.0%	1.8%	2.5%	4.3%	3.2%	3.7%	4.6%	5.0%
CDA 1-5 Yr Bond	0.4%	0.6%	1.1%	0.6%	9.0%	2.4%	2.6%	0.4%	0.6%	1.1%	0.6%	9.0%	2.4%	2.6%

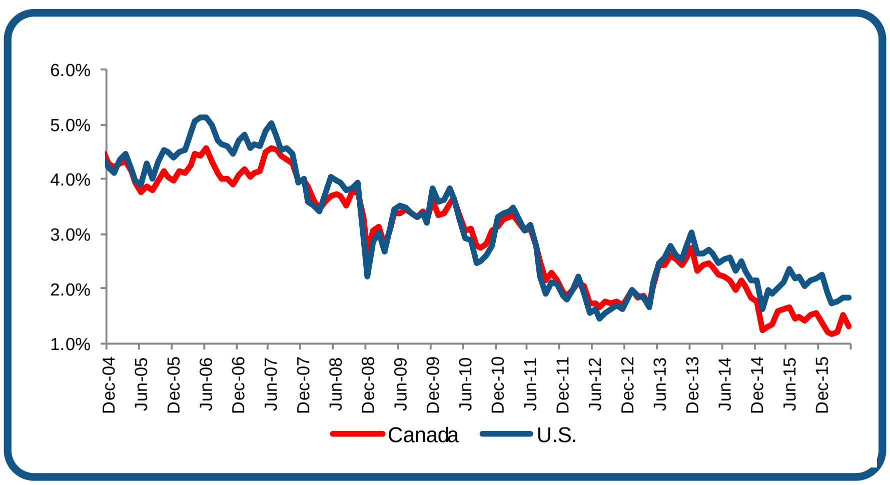
Canadian Yield Curve



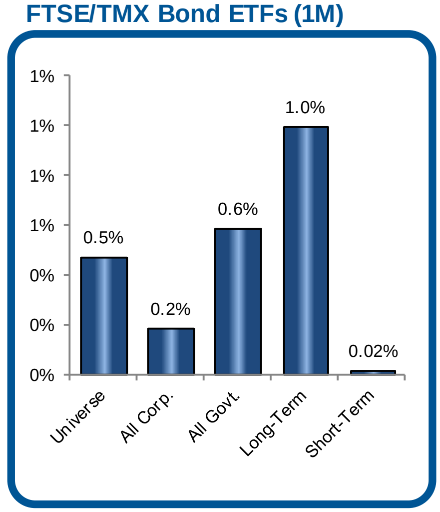
Commodities Performance (1M)



10YR Government Bond Yields



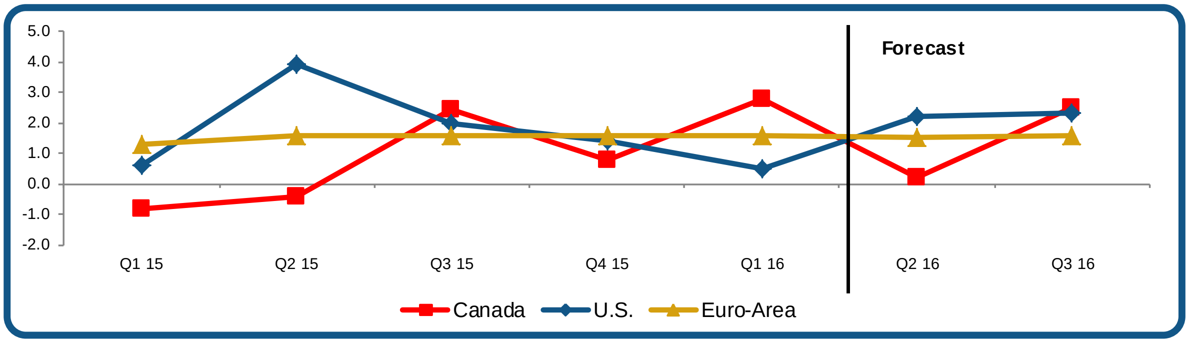
FTSE/TMX Bond ETFs (1M)



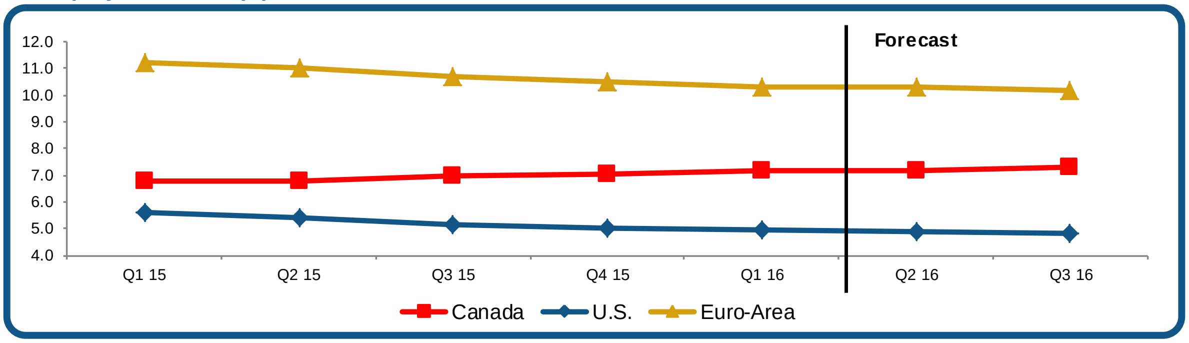
Source: Bloomberg, iShares.ca

Economic Statistics

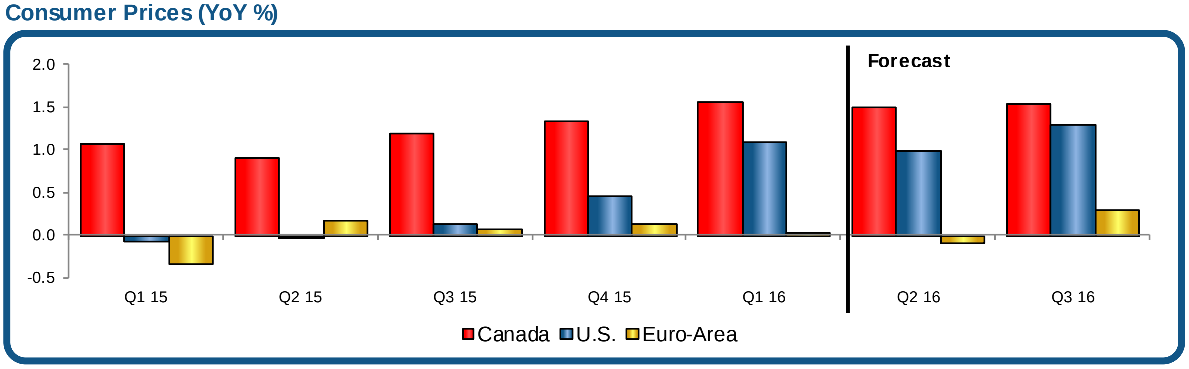
Real GDP (%)



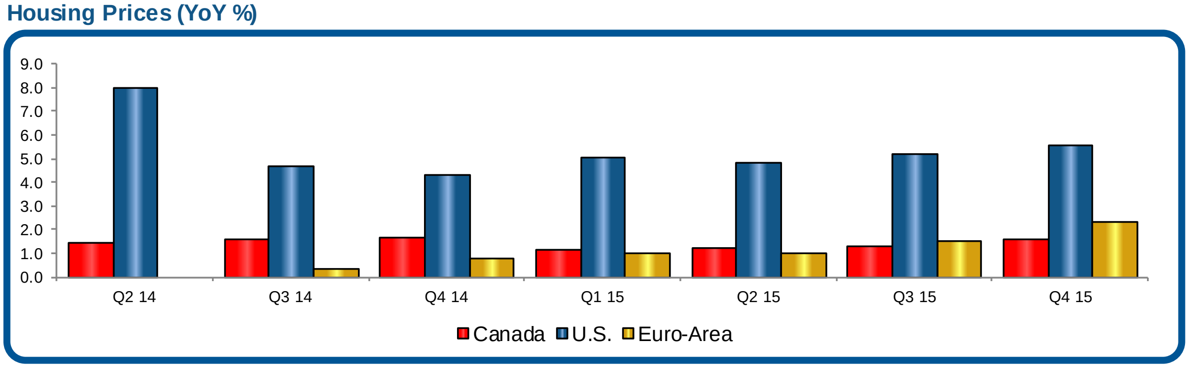
Unemployment Rate (%)



Consumer Prices (YoY %)



Housing Prices (YoY %)



Source: Bloomberg

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